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Revision of UNDP financial regulations*

Summary

In its decision 2005/1, the Executive Board requested the Administrator to establish risk guidelines with respect to (a) the commitment of resources against future receipt of contributions; and (b) exceptions to separation of duties. That decision also called for an independent expert assessment of those changes. This report outlines in greater depth the rationale for the proposed changes, the associated risks and how to mitigate them. It also includes an independent assessment of the proposals by the UNDP External Auditor, United Nations Board of Auditors.

Elements of a decision

The Executive Board may wish to approve the proposed revised financial regulations, and take note of the proposed associated financial rules.

Contents

Chapter		Page
I.	Introduction	2
II.	Commitment of resources on the basis of approved receivables	2
III.	Separation of duties	7

* The need for additional analysis has delayed submission of the present document.

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I. Introduction

1. As part of the comprehensive review of the financial regulations set out in document DP/2005/3 submitted to the Executive Board at its first regular session in January 2005, UNDP proposed changes to regulation 5.07 regarding commitment of resources against future receipt of contributions, and regulation 20.02 regarding exceptions to separation of duties. In its decision 2005/1, the Executive Board deferred consideration of these proposed changes to its annual session in June 2005, and requested the Administrator to establish risk guidelines thereon as well as an independent expert assessment with respect to those changes.

2. This report outlines in greater depth the rationale for the proposed changes, the associated risks and how to mitigate them. In response to the Board request, the revisions and guidelines referred to below have been reviewed by the UNDP External Auditor, United Nations Board of Auditors.

II. Commitment of resources on the basis of approved receivables

Proposed revised financial regulation and rule

3. In document DP/2005/03, UNDP proposed the following revisions (in bold) to regulation 5.07.

Regulation 5.07:
Contributions to ~~o~~**O**ther ~~r~~**R**esources shall be subject to the following conditions:

(a) Contributions shall be paid pursuant to an agreement made between the contributor and the Administrator;

(b) Contributions shall be paid in advance of the allocation made for the implementation of planned UNDP programme activities, **except as provided under the terms of Regulation 5.07(c)**;

(c) **Notwithstanding the provision of Regulation 5.07(b), allocations may be made on the basis of receivable co-financing contributions, in accordance with risk guidelines established by the Administrator.**

(d) ~~(c)~~ Additional costs incurred by UNDP in administering the contribution shall be fully covered from the contribution.

4. Pending the approval of revised regulation 5.07, the Administrator will promulgate a new associated financial rule that reads as follows:

Rule 105.02:

Further to regulation 5.07, the Administrator will promulgate guidelines to ensure risks are mitigated to the extent possible.

Rationale for revision to financial regulation and rule

5. Existing regulation 5.07(b) requires donors to pay their contributions to Other Resources activities fully in advance. According to this regulation, UNDP ability to enter into commitments is limited to the amount of cash contributions that have been received, which may not be sufficient to carry out activities.

6. Over time, the size of Other Resources contributions to UNDP has increased significantly. Between 1994 and 2003, Other Resources grew from $628 million to $2.5 billion. As a consequence, donors often require that their contributions be paid to UNDP in instalments rather than 100 per cent in advance. This is considered a better cash management practice by many donors, who do not wish to tie up large amounts of cash in advance of programme/project implementation. Other donors are bound by legislation that does not permit them to pay contributions fully in advance. Some contributors, particularly the European Commission, also require a holdback of a tranche of funds to be paid only after successful project completion.

7. Where it is possible for UNDP to operate under the existing regulation, there is frequently an extensive period between the signature of a donor agreement and the receipt of funds. This consequently leads to late start-up of projects/programmes, and a reduction in overall programme delivery.

8. In order to be responsive to donor concerns and practices and to facilitate more effective programme management, the Administrator suggests amending regulation 5.07 as outlined above. If a proposed donor agreement meets certain conditions outlined in the risk management guidelines outlined below, the revised regulation and associated rule would allow UNDP to commit resources for programme/project implementation, even though 100 per cent of the contribution has not been received. Such commitments usually take the form of contracts for supply of services, e.g., experts, consultants, project personnel, or for purchase of goods such as project equipment, vehicles, and so forth. Disbursements, however, would only be made once funds have been received, unless the resident representative or other senior official authorizes an override, as appropriate.

9. This request is in harmony with practices approved for UNFPA, the United Nations Children's Fund (UNICEF) and the World Food Programme (WFP).[1] Potential risks and how they may be mitigated are addressed below.

Implications for UNDP

10. Provided that the appropriate operational procedures are followed as outlined below, the risk of loss to UNDP as a result of this proposed change in regulation is seen as minimal. If commitments are entered into in advance of the receipt of contributions as per the revised regulation 5.07, three possible scenarios can occur.

11. *Scenario A: The donor pays before UNDP payment to suppliers is due.* This is the most likely scenario, and implies no loss to UNDP.

[1] UNFPA financial regulation 2.2 F (i); UNICEF financial rule 105.5; WFP financial regulation 10.8.

12. *Scenario B: The donor delays payment compared to the agreed schedule.* This, under current circumstances, is typically caused by either: (a) payment procedures on part of the donor; or (b) delays in UNDP reporting (interim and/or final reports) to donors, which consequently hold back their payments. Out of the $2.7 billion received in cost-sharing income in 2002-2003, the average amount by which expenditures temporarily exceeded income was less than 0.2 per cent, bearing in mind that overall there is never a cash deficit in Other Resources. This does not incur any loss to UNDP, apart from the limited foregone investment income that otherwise would have been earned on the funds advanced from Other Resources working capital.

13. *Scenario C: The donor fails to make the payment.* In a very limited number of instances, the donor may be unable or unwilling to make an agreed payment. A review of statistics in 2002-2004 shows that there were no write-offs resulting from donor default. Any real deficit/loss that might result from the need to honour commitments made would be covered through:

(a) Appropriate pursuit of payment from the donor in connection with the legal terms of the officially signed co-financing agreement;

(b) The provisions of regulation 5.08, which covers default of contributions to Other Resources; and

(c) Charges to the extrabudgetary income of the concerned country office or regional bureau, and as a last resort to the Other Resources reserve as provided in regulation 25.06(b).

Risk management guidelines

14. The risk management guidelines aim at minimizing the occurrence and potential consequences of scenarios B and C above, and cover the following elements summarized below:

(a) Eligibility of contributors to pay instalments rather than fully in advance;

(b) Requirement of signed co-financing agreements with donors, including payment schedule, before entering into commitments;

(c) Limitation of UNDP liability in agreements with suppliers of goods and services;

(d) Requirement of approvals before cash is disbursed; and

(e) Monitoring and proactive follow-up on due payments.

Eligibility of contributors to pay in instalments rather than fully in advance

15. To minimize the possibility of non-payment resulting from default, the ability to provide contributions in instalments rather than 100 per cent in advance will be restricted to donors with a demonstrated record of ability to pay. To assist in the assessment of payment capacity, the long-term debt ratings of Moody's, Standard & Poor's and Fitch will be used to assess this risk. Only donor countries with a rating

of 'B' or better will be eligible to pay in instalments. Standard & Poor's definition of 'B' indicates that an obligor has the capacity to meet its financial commitment on the obligation. Notwithstanding such a rating, a previous history of default with UNDP would disqualify a donor from eligibility.

16. Donor countries not meeting that standard, or that are not rated, would only be able to pay in instalments, given that a letter of credit is issued by a bank with an acceptable credit rating, as approved by the UNDP Treasurer. If the source of contribution, however, is a loan from an international financial institution (IFI), e.g., the World Bank, UNDP can accept an instalment modality, provided that a facility is assigned to UNDP by which it can draw funds directly from the IFI to meet project cash requirements.

Rating	**Able to pay in instalments, rather than fully in advance?**
≥ B	Yes
< B or Not Rated	Only if an acceptable letter of credit is issued, or a drawdown facility from an IFI is arranged

Signed co-financing agreements with donors, including payment schedule, required before entering into commitments

17. A legally binding agreement between the eligible contributor, as per the above, and UNDP has to be signed before UNDP can enter into any commitments. The agreement must specify the schedule and timing of payments, which must be set up so that payments from the donor are made in advance of anticipated cash payments from UNDP for the implementation of planned activities. The schedule of payments may be amended from time to time to be consistent with the progress of project/programme delivery and shall reflect any revisions to the anticipated total costs of activities. Standard agreements have been drawn up with the UNDP Office of Legal and Procurement Services that include standard conditions providing for the contributor's liability for all commitments and expenditures incurred in the implementation of the programme/project up to the date of notification of termination in the event that the contributor decides to terminate the agreement. Any non-standard agreements, together with detailed rationale for non-use of standard text, must be submitted to the appropriate headquarters units for review and approval prior to signature.

Limitation of UNDP liability in agreements with suppliers of goods and services

18. Contracts entered into with suppliers shall contain standard and legally cleared 'limitation of liability' clauses that permit UNDP to terminate contracts without cause at any time upon 15 days prior written notice to the contractor. In such cases, UNDP shall reimburse the contractor for all reasonable costs incurred prior to the receipt of notification. In the event of non-payment or delayed payment of contributors, such provisions will limit UNDP liability.

Approvals required before cash is disbursed

19. In those instances where a scheduled instalment payment is late, funds should not be disbursed until cash has been received, unless an override has been authorized by the resident representative or other senior official, as appropriate. The decision to approve such disbursements must be based on assurance from the donor that the payment is in progress, and entails a commitment that the country office's extra budgetary funds, or the extra budgetary funds of the regional bureau as necessary, could be charged in the first instance in the event that the contribution is not received. Funds would then be temporarily advanced from Other Resources working capital to honour commitments with suppliers.

Monitoring and proactive follow-up on due payments

20. The Enterprise Resources Planning (ERP) system, Atlas, implemented in 2004, has the facility to track/monitor funds receivable from donors systematically. Once an agreement has been signed with a contributor, the schedule of instalment payments shall be reflected in the system through the creation of "approved receivables/pending items". The recording of receivables will enable managers to monitor closely the contributor payments against agreed instalment schedules (aging of receivables), and follow up proactively with the donor on upcoming payments.

Expert assessment of proposal

21. In response to the Board request in decision 2005/1 for an independent expert assessment of these changes, UNDP has discussed the above proposal with the United Nations Board of Auditors.

22. The Board of Auditors has assessed the proposed changes to UNDP financial regulation 5.07(b) and (c), rule 105.02 and the accompanying risk management guidelines. This assessment has been limited to the information contained in this document. The Board of Auditors also took into consideration that the proposed changes are in harmony with practices already approved for UNFPA, UNICEF and WFP.

23. After taking into account the rationale for this revision, the potential risk implications for UNDP as well as the proposed risk management guidelines to mitigate these potential risks and to limit the liability for UNDP, the Board of Auditors considers the proposed changes to the regulations and rules to be appropriate, without prejudice to the results of actual audits or review and evaluation of the actual implementation.

24. Accordingly, the Board of Auditors is not in a position to assess the impact that the amended regulation and rule will have on the organization at this time. The Board of Auditors is of the view that the quality of implementation of the revised regulation and rule as well as the risk management guidelines is a key factor that needs a detailed assessment within a reasonable period of time to ensure that the risks and liabilities are indeed mitigated.

III. Separation of duties

Proposed revised financial regulation and rule

25. In document DP/2005/03, UNDP proposed the following revision to regulation 20.02:

> **Regulation 20.02:**
> **Unless otherwise expressly authorized by the Administrator, t**~~T~~here shall be a separation of duties:
>
> (a) Between the staff who may incur obligations or commitments on behalf of UNDP and the staff who may verify that payments may be made on behalf of UNDP; and
>
> (b) Between the staff who may verify that payments may be made on behalf of UNDP and the staff who may disburse resources on behalf of UNDP.

26. Pending the approval of the revised regulation 20.02, the Administrator will promulgate a new associated financial rule:

> **Rule 120.04:**
> Further to regulation 20.02, regarding exceptions to the separation of duties:
>
> (a) All exceptions will be granted by the Comptroller;
>
> (b) At least two signatories are required to authorize the expenditure of funds;
>
> (c) The exception will be granted for a maximum of 30 calendar days; and
>
> (d) The exception will be granted on the basis of proposed compensating controls by the country office or Regional Bureaux, including post facto review by another unit of all transactions over $2 500.

Rationale for revision to financial regulation and rule

27. Regulation 20.02 requires that there shall be a separation of duties among staff members that may incur obligations, verify payments and disburse resources on behalf of UNDP. The amendment reflects the need to take into account that given certain circumstances, the Administrator may grant exceptions in the interest of the organization. Such exceptions might be necessary where, for a temporary period, there is not a full complement of signatories present in a country office to effect timely payments and consequently project delivery. In such instances, at least two separate individuals would be required to authorize the expenditure of funds. This is also in harmony with the financial regulation approved for UNFPA.[2]

[2] UNFPA financial regulation 14.2

Implications to UNDP

28. Small country offices would be the most likely to experience temporary periods without a full complement of signatories. As the disbursement levels in such offices are low, and given that the post-facto controls/reviews specified below are put in place, the overall risk to UNDP is seen as very small.

Risk management guidelines

29. Exceptions to the segregation of duties will be granted on a case-by-case basis by the Comptroller for a limited time period not exceeding 30 calendar days. For such an exception to be granted, at least two individuals will have to be involved in reviewing the transaction, and appropriate compensating controls must be put in place. Required control mechanisms will include a review at headquarters or in regional centres of Atlas reports and supporting documents for all transactions above $2 500 undertaken during the prescribed period. The UNDP Office of Audit Review will also be advised of the granted exceptions, and will take this into account in formulating their audit plan.

Expert assessment of proposal

30. The Board of Auditors has assessed the proposed changes to UNDP financial regulation 20.02, rule 120.04 and the accompanying risk management guidelines. This assessment has been limited to the information contained in this document. The Board of Auditors also took into consideration that the proposed changes are in harmony with practices already approved for UNFPA.

31. After taking into account the rationale for this revision, the potential risk implications for UNDP as well as the proposed risk management guidelines to mitigate these potential risks and to limit the liability for UNDP, the Board of Auditors considers the proposed changes to the regulations and rules to be appropriate, without prejudice to the results of actual audits or review and evaluation of the actual implementation.

32. Accordingly, the Board of Auditors is not in a position to assess the impact that the amended regulation and rule will have on the organization at this time. The Board of Auditors is of the view that the quality of implementation of the revised regulation and rule as well as the risk management guidelines is a key factor that needs a detailed assessment within a reasonable period of time to ensure that the risks and liabilities are indeed mitigated.